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No. 392

IN THE

Supreme Court of the United States

OCTOBER TERM, 1964

SIDNEY C. KLEINMAN and JANICE R. KLEINMAN,
Objectors-below, Petitioners,

vs.

HYMAN SAMINSKY and BETTY SIEGEL, Trustee for JOAN C. SIEGEL,
Plaintiffs-Respondents,

and

CHARLES C. ABBOTT, WILFRED GODFREY, J. LEE POTTER, ORA C. ROEHL, ERWIN H. SCHELL, SIDNEY L. SHOLLEY, CAMERON S. THOMPSON, SAM G. BAGGETT, GLENN N. LEMPEREUR, KEYSTONE CUSTODIAN FUNDS, INC., KEYSTONE CUSTODIAN FUNDS, INC., as Trustee, and THE KEYSTONE COMPANY OF BOSTON,
Defendants-Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF THE STATE OF DELAWARE.

ALEX ELSON
WILLARD J. LASSERS
AARON S. WOLFF
11 South LaSalle Street
Chicago, Illinois 60603

ARTHUR T. SUSMAN
208 South LaSalle Street
Chicago, Illinois 60604
Counsel for Petitioners

FRANK J. MILLER
325 Delaware Trust Building
Wilmington, Delaware
Of Counsel.

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PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF THE STATE OF DELAWARE.

To the Justices of the Supreme Court of the United States:

Petitioners, Sidney C. Kleinman and Janice R. Kleinman, respectfully petition for a writ of certiorari to review the judgment of the Supreme Court of Delaware entered April 22, 1964.

OPINIONS BELOW.

The opinion of the Court of Chancery of Delaware is reported at 194 A.2d 549 (1963) and is printed in the Petitioners' Appendix below, p. 63. The opinion of the Supreme Court of Delaware is reported at 200 A.2d 572 (1964) and is printed in the Appendix to this petition at p. 1a.

Another opinion of the Chancery Court which is related to this case but not directly relevant here is reported at 185 A.2d 765 (1961).

JURISDICTION.

The judgment of the Supreme Court of Delaware was entered on April 22, 1964. A timely petition for rehearing was denied on May 19, 1964.

The jurisdiction of this Court to entertain the petition for a writ of certiorari is based on 28 U.S.C. § 1257(3).

QUESTIONS PRESENTED.

Do the provisions of the Investment Company Act for independent directors and protection against self-dealing and conflict of interest between investment companies and their managers—and more particularly the requirements that at least 40% of the board of directors of a registered investment company be independent of or unaffiliated with the company's "investment adviser" and that investment advisory contracts be approved by a majority of the independent directors and the investors of the company—apply to a registered investment company organized as a common law business trust and its corporate trustee, which trustee serves also as the depositor and investment adviser of the company and whose directors are also the directors of the

investment company? The court below held that the investment adviser was exempt as such as a trustee under §2(a)(19) of the Act.

STATUTE INVOLVED.

The pertinent provisions of the Investment Company Act of 1940, 15 U.S.C. 80a-1, *et seq.*, are set forth in the Appendix, pp. 10a-14a.[1]

STATEMENT.

This case concerns the application of the Investment Company Act to approximately one-fourth of the investment companies subject to registration under the Act, and particularly to the Funds involved here which have assets exceeding three-fourths of a billion dollars and more than 230,000 investors.

The action was commenced on August 2, 1960, when Hyman Saminsky on his own behalf and representatively on behalf of all other holders of certificates of participation of the Funds filed a complaint in the Court of Chancery in New Castle County, Delaware. The Funds are a series of ten common law trusts, registered under the Act and are commonly known as "open-end" mutual

[1] The Investment Company Act is contained in 15 U.S.C. 80a-1, *et seq.* The numbering of the first 28 sections of the Act is the same in both the Act and the Code. Section 29 of the Act, an amendment of the Bankruptcy Act, does not appear in 15 U.S.C. Hence Section 30 of the Act is § 80a-29 etc.

funds (PA 16, 17).[1] The individual defendants are, *inter alia*, directors of defendant Keystone, a Delaware corporation, trustee of and investment adviser to the Funds (PA 17). The defendant The Keystone Company of Boston, a Delaware corporation ("Keystone of Boston"), is a wholly-owned subsidiary of Keystone and is the sole underwriter of certificates of participation in the Funds (PA 17).

The complaint as finally amended and supplemented on March 29, 1963, charges that defendants had committed waste of assets of the Funds, in that management fees and recurring charges were excessive and a spoliation of Funds' assets; that defendants had breached the fiduciary duty owed to plaintiffs by self-dealing with respect to the awarding of the underwriting contract to Keystone of Boston (a wholly owned subsidiary of Keystone), that excessive fees had been charged and accepted by Keystone for investment advisory services, that Keystone had engaged in the practice of "reciprocals" with respect to the awarding of brokerage business; that the underwriting contract and advisory fee schdule and contract had not been submitted to the certificateholders as required by the Act; and that certain other violations of law had been committed by defendants (PA 16-25). The complaint specifically charged that defendants violated §§1(b)(2), 10, 15, 17(h)(i), 36 and 37 of the Act (PA 21).

The Funds were established on July 15, 1935, by the execution of identical trust agreements or declarations of trust (DA 1-18). By the terms of the trust agreements, Keystone maintains complete control over investment

[1] Citation to the Record-Appendices below of objectors-petitioners and defendants-respondents is "PA" and "DA," respectively. Citation to the Appendix to this Petition is "App."

policy and performs all necessary services as an investment adviser and all the clerical work for the Funds. For example, the trust agreements require that Keystone shall:

1. receive the cash and securities of the Funds and the proceeds from the sale of certificates and deposit them with a custodian (Art. I, Sec. 1; Art. II, Sec. 1(a); DA 3, 8);

2. determine the manner in which the Funds' assets shall be invested and what securities shall be bought and sold (Art. I, Secs. 8-10; Art. II, Sec. 1(b); DA 6, 8);

3. arrange for the continuing supervision of the Funds and exercise all rights of owners with respect to securities included in the Funds (Art. II, Sec. 1(d); DA 8); and

4. maintain proper accounting records and prepare all reports and tax returns as may be required under state and federal law (Art. II, Sec. 1(i)-(1); DA 8-9).

Clearly, under these trust agreements, Keystone, at one and the same time, is the trustee, depositor and investment adviser of the Funds.

Under the trust agreements Keystone charges the Funds for its services a management fee of ½ of 1% per annum of the first $150,000,000 of assets of the Funds and 3/8 of 1% per annum of assets in excess of $150,000,000. In addition Keystone receives a so-called "recurring charge" of ¼ of 1% per annum of the net asset value of the Funds. The "recurring charge" is stated to be in lieu of all expenses of operations of the Funds, except the management fee and taxes[1] (DA 4). From 1954 to 1962 Keystone

[1] In Saminsky v. Abbott, 185 A. 2d 765 (Del. Ch., 1961), discussed below, the chancery court determined that the excess of recurring charges over actual expenses constituted additional management fees.

received from the Funds recurring charges of $9,342,087 and management fees of $15,820,898 or a total of more than $25,000,000. In 1962 alone, Keystone received a recurring charge of $1,644,891 and a management fee of $2,652,026 based on net assets of $677,768,800 (PA 18, 19). In June, 1963, net assets of the Funds exceeded $771,000,000 and there were more than 230,000 holders of certificates of participation (PA 64).

The individual defendants, who are the directors of Keystone, act also as directors of the Funds (PA 9, 11-15; DA 13). The individual defendants regularly pass upon additions to and eliminations from the portfolio of each fund; dividend distributions; selection of independent accountants; recommendations to certificateholders as to amendments of the contract; proxy statements distributed to certificateholders; registration under the Securities Act of 1933 and state blue sky laws; detailed financial statements for each fund; and reports on economic and business outlook as related to porfolio transactions (*Ibid.*).

Subsequent to filing answers to the first amended complaint, defendants moved for summary judgment on November 4, 1960. On September 18, 1961, the chancellor granting the motion in part and denying it in part, held, *inter alia*, that the underwriting contract between Keystone of Boston and Keystone was void under §46(b) of the Act because it had not been approved by the Funds' investors as required by §15(b)(1) of the Act (*Saminsky* v. *Abbott*, 185 A. 2d 765 (Del. Ch., 1961)).

While supplemental briefs pertaining to the summary judgment motion were under consideration by the chancery court, defendants called a meeting of the Funds' investors for the purpose of sanctioning the current and past underwriting agreements between Keystone and Keystone of Boston and also the payment of management fees and

recurring charges by the Funds to Keystone. Approval was obtained on January 18, 1963 (see 194 A.2d at 550-1; PA 30).

After approval and while the further matters concerning the motion for summary judgment were pending: (1) plaintiffs filed their final amended and supplemental complaint described above; (2) defendants answered; and (3) plaintiffs and defendants agreed upon and submitted to the chancery court a plan of settlement of the action.

Pursuant to Rule 23, Delaware Chancery Rules, notice was given certificateholders of the Funds for a hearing on the fairness, reasonableness and adequacy of the plan of settlement (PA 31-40). Petitioners as certificateholders of one of the Funds, filed their Notice of Intention to Appear, Statement of Position, attended the settlement hearing, and presented evidence and argument to the Chancellor in opposition to the plan of settlement (PA 40-63).

One of the petitioners' objections was that the proposed settlement perpetuated a violation of the Act in that it permitted the Funds to continue to operate with no directors who were independent of Keystone (PA 43, 46-8).

In approving the settlement agreement the court of chancery specifically overruled this objection (194 A.2d at 551; PA 66-7). The court assumed there was a continuing conflict of interest but that this conflict was not proscribed by the Act (*Ibid*).

Petitioners, who were the only objectors, appealed to the Supreme Court of Delaware. That court held that the Funds and Keystone were exempt from the requirement of independent directors under §§10 and 15 of the Act because Keystone was not an investment adviser. The court reached this conclusion in the following manner (200 A. 2d at 576; App. 6a-7a):

> "Next, appellants argue that since the Funds as such had no board of directors and since the directors

of Keystone, the trustee, performed the functions of a board of directors of the Funds, it follows that the individual defendants are at one and the same time directors of the investment adviser, Keystone, and of the Funds in violation of §10(a) of the Act which prohibits more than 60% of such a board from being 'affiliated' with the investment adviser. It is therefore argued that the complaint set forth a valid enforceable claim under the Act which was improvidently given up by the settlement.

"In the first place, Keystone is not the investment adviser of the Funds. It is the trustee. As such, therefore, it is exeluded in terms from the statutory definition of an investment adviser found in §2(a)(19) of the Act. Furthermore, there is in existence no investment advisory contract between Keystone and the Funds which, under §15(a) of the Act, must by law be approved by a majority of the shareholders.

"In the second place, since the Funds do not have an investment adviser within the meaning of the Act, it follows that there is none with whom directors of the Funds could be 'affiliated' within the prohibitory limits of §10(a) of the Act. Furthermore, it is obvious to us that the relationship between Keystone and the Funds and its certificate holders is that of trustee and beneficiary. The propriety of this relationship under the Act seems to be recognized by §16(b).

"The whole of appellants' argument based upon the Act seems little more than an attempt to distort the true nature of the Funds and Keystone into a mold which would fit neatly into one of the prohibited areas of the Act. The difficulty is, however, that the argument in reality is a complaint that the Congress did not pass the Act in a form more acceptable to appellants."

Based on this erroneous construction of the Act, the Delaware Supreme Court affirmed the approval of the settlement agreement and thereby perpetuated a continuing violation of the Act. It is from the judgment based on this opinion that the petition for certiorari is filed.

REASONS FOR GRANTING THE WRIT

1. The Court Below Erroneously Decided a Substantial Federal Question.

The Delaware Supreme Court has erroneously decided a substantial question of federal law which has not been, but should be, decided by this Court. The Investment Company Act of 1940 requires that investment companies and their investors be insulated against overreaching by management and advisers. Among the various protections against self-dealing is the requirement that investment companies have at least a minority of directors independent of the investment adviser. Do these and other related provisions apply to the Funds and Keystone? Keystone created the Funds as a common law business trust and appointed itself as sole trustee of the Funds. Keystone serves as their depositor, directs their investment and otherwise performs all of the functions and duties of an investment adviser and receives substantial fees for such services. Keystone's directors are also the directors of the Funds.

The court below held the Act's provisions against self-dealing inapplicable by construing §2(a)(19)(A) of the Act to exclude Keystone as an investment adviser because it is a "trustee". We think the Delaware Supreme Court plainly misconstrued the Act.

Based on this misconstruction, the court below concluded that §§10 and 15 of the Act were inapplicable (200 A. 2d at 576; App. 6a-7a) even though in these provisions Congress went to great "pains • • • to insure an adequate representation by independent directors". *Brown* v. *Bullock*, 294 F. 2d 415, 421, n. 3 (C.A. 2, 1961).

Section 10(a) and (h) was designed to protect against overreaching by those in control of investment companies

by requiring that at least 40% of the directors of the company or the depositor of the company be independent of the directors of the adviser. Similarly, §15(a), (c), (d) and (e) was designed to prevent overreaching in relation to investment adviser fees and agreements by providing for their periodic scrutiny and approval by a majority of independent directors and the investors.

By its determination that Keystone is a trustee and hence not the Funds' investment adviser the court below approved a settlement of the litigation which bars forever to 230,000 public investors, who have invested in the Funds over $770,000,000.00, the protection of disinterested directors that Congress plainly intended such investors to have.

Moreover, the decision below, if permitted to stand, will deprive an even larger segment of the investing public of these protections against self-dealing and conflict of interest. A recent, exhaustive and authoritative study found that approximately one-fourth of the open-end investment companies studied are organized as trust entities and that these trusts hold about one-fourth of the assets of the mutual fund industry. *A Study of Mutual Funds*, Prepared for the Securities and Exchange Commission by the Wharton School of Finance and Commerce, H. Rep. No. 2274, Comm. on Interstate and Foreign Commerce, 87th Cong., 2d Sess. (1962), p. 6.

Had Congress wished to exclude from the Act's protection such a large segment of investment companies and public investors, it would have said so plainly. If the decision below is correct, the Act may be evaded today simply by creating investment companies in the form of common law trusts and by naming a "trustee" to perform all of the functions of the investment adviser.

But Congress found and declared in §1(b) of the Act:

> "• • • that the national public interest and the interest of investors are adversely affected—
>
> • • •
>
> "(2) when investment companies are organized, operated, managed, or their portfolio securities are selected, in the interest of directors, officers, investment advisers, depositors, or other affiliated persons thereof, in the interest of underwriters, brokers, or dealers, • • • rather than in the interest of • • • security holders; • • •."

Congress further stated that it is the "policy and purposes" of the Act "to mitigate and, so far as it is feasible, to eliminate" the abuses enumerated and that the Act "shall be interpreted" in accordance with such policy and purposes (*ibid.*).

The Investment Company Act of 1940 went far beyond the earlier federal securities acts, which were primarily disclosure statutes, since Congress concluded that mere disclosure legislation would not provide adequate protection to investment company shareholders. See S. Rep. No. 1775, 76th Cong., 3d Sess., pp. 11-12; H. Rep. No. 2639, 76th Cong., 3d Sess., p. 10. Congress provided for detailed regulation of virtually all aspects of the investment company industry. It carefully specified the duties and obligations of persons who, through their participation in and affiliation with investment company management and operation, control the vast assets possessed by these companies. Specifically, in §§10 and 15, Congress implemented its findings by providing some independence —a buffer—between the investors and the company on

one hand and those in control of the company on the other.[1]

Although "trustee" is not defined expressly in the Act, this Court has said with respect to securities legislation: "* * * that courts will construe the details of an act in conformity with its dominating general purpose, will read text in the light of context and will interpret the text so far as the meaning of the words fairly permits so as to carry out in particular cases the generally expressed legislative policy." (*S.E.C.* v. *C. M. Joiner Leasing Corp.*, 320 U.S. 344, 350-1 (1943).) See also *American Power and Light Co.* v. *S.E.C.*, 329 U.S. 90, 104 (1946).

In construing §2(a)(19) of the Act the court below did not even pay lip service to the overriding purpose and design of the Act. It made no attempt to gather the meaning of "trustee" in the "light of context" or "legislative policy" as directed by this Court in *Joiner*. If it had, it would have found that "trustee" did not include a person who exercised all the powers and functions of an investment adviser. The "trustee" exemption was included for quite a different purpose—it was intended simply to

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[1] With respect to §10(a) defendants concede that the directors of Keystone are the directors of the Funds (PA 9, 11-15; DA 13). Whether these directors constitute the "board of directors" of the Funds within the meaning of §10(a) is immaterial because of §10(h)(1). Read together these sections require that "no depositor of a registered investment company shall have a board of directors more than 60 per centum of the members of which are persons who are investment advisers of, affiliated persons of an investment adviser of * * * such registered company." Here Keystone is the depositor as well as the adviser, and the board of directors of the depositor is identical to that of the adviser.

exclude individual members of a board of trustees of an investment company, as such. If it applies at all to a corporate trustee-creator of an investment company, it applies only to a "naked" trustee or custodian who has no responsibility for operations.

Section 2(a)(19) reads as follows:

> "'Investment adviser' of an investment company means (A) any person (other than a bona fide officer, director, trustee, member of an advisory board, or employee of such company, as such) who pursuant to contract with such company regularly furnishes advice to such company with respect to the desirability of investing in, purchasing or selling securities or other property, or is empowered to determine what securities or other property shall be purchased or sold by such company, * * *."

All of the persons mentioned in the parenthetical phrase, other than "trustee" are individuals who are part of the investment company family. Clearly, officers, directors and employees have this status. So do members of an advisory board. Under ordinary rules of construction, "trustee" being in the same class as individual officers, directors, members of an advisory board and employees, "trustee" must also be construed to mean an individual trustee. Moreover, as to such persons, Congress chose a regulatory scheme different from that applicable to "investment advisers." For example, directors must be elected by the investors (§16); officers must not constitute more than 60% of the board of directors (§10(a)); and members of an advisory board are subject to the same restrictions as the board of directors (§10(g)).

In light of the statutory pattern the meaning of "trustee" in the list of exemptions becomes clear: the trustee referred to is a member of a board of trustees which

board functions as a board of directors. Such an individual, performing the customary functions of a member of a board of trustees, was not to be deemed an investment adviser merely because of such membership. Congress was fully aware that investment companies were managed by boards of trustees as well as boards of directors (See §16(a)(b)).

The legislative history is also clear that in §2(a)(19) Congress did not include as "trustee" a trustee who exercised the powers of an investment adviser. On the contrary, the Senate Report on the bill that was enacted shows that Congress had in mind a passive trustee or custodian who had no responsibility for the operation of the trust funds. See S. Rep. No. 1775, 76th Cong., 3d Sess., pp. 8, 9-10. Reading the text of §2(a)(19) in the light of context it is clear that a "trustee" is not "bona fide" and acting "as such" when it is also exercising the powers of an investment adviser.

The court below erroneously interpreted "trustee" to include a corporate creator of the Funds which had designated itself as "trustee" with all the powers and duties of an investment adviser. In doing so it failed to read language in context and arrived at a result which nullifies the entire scheme of statutory protection designed to safeguard the investment company from its investment adviser.

Keystone, while in name a "trustee", exercises all of the powers and functions of an investment adviser as described specifically in §2(a)(19)(A). It has received and is receiving millions of dollars annually for performing the functions and services of an adviser. To hold that it is not an adviser because it is a "trustee" does violence to the Act.

Apparently not certain in its conclusion that Keystone is not an investment adviser because it is a "trustee," the court below held also that Keystone is not an adviser because there is no existing advisory contract (200 A. 2d at 576; App. 7a).

The written trust agreements which created the Funds expressly determine the functions and duties that Keystone is to perform for the Funds and sets forth the fees that Keystone is to receive from Funds for performing these functions and services (DA 4, 6, 8). As shown above these functions are precisely those of an investment adviser as defined in the Act. Patently, the trust agreement is also an investment advisory contract subject to the requirements of §15. Obviously the defendants thought so too since they sought and obtained investor approval of the fees paid under this agreement as a defense to this litigation (PA 30). In failing to construe the trust agreement as an advisory contract the court below again gave form precedence over substance and ignored the dominant purposes of the Act. This failure led the Court to the false conclusion that a majority of independent directors and a majority of investors are not entitled to pass upon the fees and other arrangements between Keystone and the Funds as required by §15 (a), (c), (d) and (e) of the Act (200 A. 2d at 576; App. 7a).

The facts in this case amply demonstrate the need for the full protection that Congress intended investors to have. Without independent representation among the directors, the Funds under the total domination of the investment adviser, have been required to pay advisory fees far in excess of a fair and reasonable amount. While the settlement approved below does reduce the fees to some extent, even the Chancellor acknowledged that the "benefits are not too great." (194 A.2d at 552; PA 68). If

the Funds had some directors independent of Keystone's directors, the investors might have obtained a more meaningful settlement. Indeed, had there been such independent directors this entire litigation might have been unnecessary.

In failing to require independent directors, the settlement falls far short of the relief to which the investors are entitled under the Act. The presence of independent directors will make supervision of the Funds' operations on a day-to-day basis, which no certificate-holder can hope to achieve, however diligent. "It is a well known fact that investors in mutual funds are primarily small shareholders. Very few of them have a sufficiently large financial interest in the management of the fund to risk any considerable sum on the outcome of litigation." *Chabot* v. *Empire Trust Co.*, 301 F. 2d 458, 461 (C.A. 2, 1962). The presence of such directors will make possible an independent voice in the determination of the advisory fees and the selection of securities and other significant questions relating to the day-to-day operation of the Funds. As a spokesman for investment advisers of investment trusts advised Congress in opposing the Act:

> "• • • from the point of actually running the fund, we find that our one independent director has a great deal of weight with us, and we hesitate, even with eight against one, when he feels strongly about a matter, to vote him down simply because we outnumber him. • • •
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> • • •
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> "• • • I think any firm of investment counsel would necessarily hesitate to follow an investment course opposed by independent minority directors, no matter how sound that course should appear." Hearings on S. 3580 Before a Subcommittee of the Comm. on Banking and Currency, 76th Cong., 3d Sess., p. 703.

The 230,000 investors in the Funds should not be deprived of this protection.

2. The Decision Below Is Not in Accordance With Applicable Decisions of This Court or Lower Federal Courts.

The Delaware Supreme Court rendered a narrow, grudging and pro forma interpretation of the Act, stating that petitioners' real complaint is that "Congress did not pass the Act in a form more acceptable to [investors]." (200 A.2d at 576; App. 7a).

In reaching that result the court below did not consider the only case decided (to our knowledge) by this Court with respect to the Act in question—a case that is controlling here, *S.E.C.* v. *Variable Annuity Life Ins. Co.*, 359 U.S. 65 (1959).

In that case, defendant argued, *inter alia*, that as an "insurance company" it was specifically excluded as an "investment company" by §§3(c)(3) and 2 (a)(17) of the Act. This Court, looking to substance and the dominant purpose of federal securities legislation, held that even though defendant was an insurance company the specific exemption was inapplicable because defendant was not issuing "insurance" but investment contracts. Even though there were strong policy reasons for exempting insurance companies—namely, that insurance companies are regulated traditionally by the states, the Court looked to the overriding federal policy. Mr. Justice Douglas noted the special requirements of the Investment Company Act (359 U.S. at 67, note 2) and in their concurring opinion Mr. Justice Brennan and Mr. Justice Stewart said (359 U.S. at 85-6):

> "• • • the detailed protections of the 1940 legislation—disclosure of investment policy, regulation of changes of that policy, of capital structure, conflicts

> of interest, investment advisers—all become relevant in an acute way here. These are the basic protections that Congress intended investors to have when they put their money into the hands of an investment trust; there is no adequate substitute for them in the traditional regulatory controls administered by state insurance departments, because these controls are not relevant to the specific regulatory problems of an investment trust."

While the Court did not there decide the specific question involved here, the principle enunciated is controlling. If it is erroneous to exempt as an investment company an insurance company issuing investment securities, it is also erroneous to exempt as an investment adviser a trustee that is performing all the functions and duties of an adviser. The decision below is out of harmony with the broad sweep and purposes of the Act as stated by Congress and this Court in the *Variable Annuity* case.

In every case before this Court arising under other federal securities laws this Court has uniformly held that the acts are to be broadly construed to give effect to their dominant purpose. With respect to the Investment Advisers Act of 1940, Title II to the Act in question, this Court held that Congress intended to prevent all conflicts of interest which might incline an investment adviser—consciously or unconsciously—to render advice which was not disinterested and said:

> "Congress intended the Investment Advisers Act of 1940 to be construed like other securities legislation 'enacted for the purpose of avoiding frauds,' not technically and restrictively, but rather flexibly to effectuate its remedial purposes."

S.E.C. v. *Capital Gains Research Bureau, Inc.*, 375 U.S. 180 at 195 (1963).

See also *S.E.C.* v. *C.M. Joiner Leasing Corp.*, 320 U.S. 344 (1943), *supra*, and *Deckert* v. *Independence Shares Corp.*, 311 U.S. 282 (1940) with respect to the Securities Act of 1933; and *J. I. Case Company* v. *Borak*, ... U.S. ...., 84 S. Ct. 1555 (1964) with respect to the Securities Exchange Act of 1934. The *Borak* case also makes clear that if *Brouk* v. *Managed Funds, Inc.*, 286 F. 2d 901 (C.A. 8, 1961), had not been vacated as moot, 369 U.S. 424 (1962), this Court would have reversed the *Brouk* decision which narrowly construed the Act to negate implied private rights of action under the Act. See also *Brown* v. *Bullock*, 294 F.2d 415 (C.A. 2, 1961).

The decision below is also in conflict with numerous decisions of lower federal courts. In *Prudential Insurance Co.* v. *S.E.C.*, 326 F.2d 383 (C.A. 3, 1964), *cert. denied*, ... U.S. ....., 84 S. Ct. 1629 (1964), the court started "with the premise that securities legislation must be broadly construed * * * to insure [investors] a full measure of protection," and concluded:

> "The Investment Company Act of 1940 contains significant safeguards for the protection of those who, like the purchasers of variable annuities, invest in 'securities.' These safeguards, characterized by the Commission as insuring 'corporate democracy,' include disclosure of investment policy and operating practices, and the regulation of fees, * * *. The mere fact that the investment program * * * is under the aegis of an insurance company [or in this case a "trustee"] ought not to negate compliance with these controls in the absence of compelling circumstances. We find no such circumstances here." 326 F. 2d 383, 386, 388.

Nor did the court below find, or even look for, such circumstances here.

The need for and implementation of a broad construction of the 1940 Act particularly with respect to eliminating or mitigating conflict of interest and self-dealing by those in control of investment companies is also exemplified in *Chabot* v. *Empire Trust Company*, 301 F. 2d 458 (C.A. 2, 1962); *Aldred Investment Trust* v. *S.E.C.*, 151 F. 2d 254 (C.A. 1, 1945), *cert. denied*, 326 U.S. 795 (1946); and *cf. Taussig* v. *Wellington Fund, Inc.*, 313 F. 2d 472 (C.A. 3, 1963), *cert. denied*, 374 U.S. 806.

The court below did not interpret the Act so as "to mitigate, and so far as is feasible, to eliminate" conflict of interest and self-dealing as required by Congress in §1(b). Nor did the court below interpret the Act in accordance with its dominant purpose as required by this Court in *Variable Annuity, supra*, and other decisions of this Court and lower federal courts cited above. It is respectfully suggested that this Court exercise its supervisory powers and overturn the decision below so that a large segment of small investors will not be denied the protection that Congress plainly intended such investors to have.

CONCLUSION

For the reasons heretofore set out, petitioners respectfully request that this Court issue a writ of certiorari to the Supreme Court of Delaware and reverse the judgment of that court.

Respectfully submitted,

ALEX ELSON
WILLARD J. LASSERS
AARON S. WOLFF
11 South LaSalle Street
Chicago, Illinois 60603

ARTHUR T. SUSMAN
208 South LaSalle Street
Chicago, Illinois 60604
Counsel for Petitioners

FRANK J. MILLER
325 Delaware Trust Building
Wilmington, Delaware
Of Counsel

August 14, 1964

APPENDIX.

IN THE
SUPREME COURT OF THE STATE OF DELAWARE

SIDNEY C. KLEINMAN and JANICE R. KLEINMAN,
Objectors-below,
Appellants,
vs.
HYMAN SAMINSKY and BETTY SIEGEL, Trustee for Joan Siegel,
Plaintiffs-below,
Appellees,
and
CHARLES C. ABBOTT, WILFRED GODFREY, J. LEE POTTER, ORA C. ROEHL, ERWIN H. SCHELL, SIDNEY L. SHOLLEY, CAMERON S. THOMPSON, SAM G. BAGGETT, GLENN N. LEMPEREUR, KEYSTONE CUSTODIAN FUNDS, INC., KEYSTONE CUSTODIAN FUNDS, INC., as Trustee, and THE KEYSTONE COMPANY OF BOSTON,
Defendants-below,
Appellees.

No. 80, 1963.

(April 22, 1964)

TERRY, *C.J.*, WOLCOTT and CAREY, *JJ.*, sitting.

Appeal from the Court of Chancery in and for New Castle County.

WOLCOTT, *J.:*

This is an appeal from the approval by the Chancellor of an agreement settling a derivative action brought on behalf of the ten Keystone Custodian Funds (hereafter

"the Funds") against the Trustee of the Funds, Keystone Custodian Funds, Inc., (hereafter "Keystone"), its directors, and The Keystone Company of Boston (hereafter "Keystone of Boston"), a wholly-owned subsidiary of Keystone, and the sole underwriter of certificates of participation in the Funds. Both corporate defendants are Delaware corporations.

The Funds are ten common law trusts created in 1935. Each fund is an open-end investment company registered as such under the Investment Company Act of 1940 (19 U.S.C., §§80a-1, *et seq.*), (hereafter the "Act"). Each fund differs from the others in the matter of investment portfolios and objectives. Under the trust agreements creating the Funds the certificate holders cannot vote for the election of a board of directors. In fact, the Funds has no board of directors as such.

The ten funds each exist under a separate trust agreement. Keystone is the trustee under each of the trust agreements. Under the terms of the trust agreements Keystone performs all of the investing management and administrative services required by the Funds. In return for its services the trust agreements provide for the annual payment to it of a management fee of ½ of 1% on the first $150,000,000 in aggregate assets and of ⅜ of 1% on aggregate assets in excess of that amount. The trust agreements provide for the payment to Keystone of an annual "recurring charge" of ¼ of 1% in lieu of all operating and administrative expenses.

Certificates of participation in each of the funds are offered for sale by Keystone of Boston pursuant to a principal underwriting contract between Keystone and Keystone of Boston. The holder of a certificate of participation by reason of his purchase becomes a party to the

trust agreement governing the fund in which he participates.

As a result of the operation of the Funds its net assets grew from approximately $282,500,000 in 1952 to approximately $677,760,000 in 1962. Keystone's management fee grew from approximately $1,100,000 in 1954 to approximately $2,650,000 in 1962, and the recurring charge collected by Keystone grew from approximately $600,000 in 1954 to approximately $1,645,000 in 1962. In June of 1963 the net assets of the Funds totaled more than $770,000,000.

Keystone of Boston, wholly owned by Keystone, the sole distributor of the certificates of participation of the Funds, pursuant to its agreement with Keystone, charged the purchasers a sales load or commission equal to 8.3% of the sales price on all sales up to $25,000 and smaller percentages on larger sales. For the period 1954 to 1962 the net return to Keystone of Boston has ranged from approximately $929,000 to $2,895,000.

This action was instituted on behalf of the Funds and charged that the defendants had committed waste of the Funds' assets by causing the payment of excessive management fees and recurring charges; that defendants had breached their fiduciary duty by awarding the underwriting contract to Keystone of Boston, and that the underwriting contract and management fee schedule were void because they had not been submitted to the certificate of participation holders for approval as required by the Act.

Defendants answered denying any wrongdoing and moved for summary judgment based upon the pleadings, affidavits, exhibits and depositions. Defendants' motion for summary judgment was granted in part and denied in part by the Chancellor. *Saminsky* v. *Abbott*, 185 A.2d 765.

The Chancellor held that the fact that the trust agreements in question provided for a schedule of fees to Keystone, the trustee, did not estop the investors in the Funds from objecting to allegedly excessive compensation to the trustee under the principles of *Rogers* v. *Hill*, 289 U.S. 528, 53 S.Ct. 731, which he held to be applicable to those common law business trusts. He also held that such amount of the recurring charges as could be demonstrated to be in excess of the actual operating expenses of the Funds should be considered as additional compensation to Keystone. However, the Chancellor reserved for trial on the merits the factual determination of these issues.

With respect to the underwriting contract with Keystone of Boston, the Chancellor held the contract void as a violation of the Act for the failure to submit it periodically for shareholder approval as required by the Act. With respect to the argument made by plaintiffs to the effect that Keystone was acting as investment adviser of the Funds in violation of the Act, the Chancellor gave judgment for the defendants.

We point out that the correctness of none of these holdings of the Chancellor is before us in this appeal for the reason that the appeal is from his approval of an agreement of settlement of the action brought about in part at least by these rulings. Neither side to the appeal seeks review of the correctness of his rulings made in his first opinion.

Following the Chancellor's decision, leave was granted the defendants to file further affidavits and a brief in support of their original motion. Prior to reargument of the summary judgment motion, the holders of the certificates of participation of the Funds at a meeting called for the purpose overwhelmingly ratified and approved all

payments to Keystone of management fees and recurring charges, and further approved a new underwriting contract between Keystone and Keystone of Boston, at the same time ratifying and approving the past underwriting contracts and transactions under them. More than 90% of the certificate holders of each fund voted for ratification. There is no contention made that Keystone failed to make full disclosure of the matters the certificate holders were being asked to ratify and approve.

Thereafter, negotiations between the parties resulted in an agreement of settlement. In brief, the settlement agreement provided for a scaled-down schedule of management fees and recurring charges which, on the basis of net assets of $771,000,000 at the time of settlement, amounted to an annual savings to the Fund of in excess of $250,000. The agreement of settlement also provided that the certificate holders would have the permanent right to reject any increase in compensation proposed by Keystone, and that for a period of eight years Keystone would not seek any increase in compensation unless a change in circumstances made its compensation unreasonably low and the Chancellor granted leave to Keystone to submit the proposed increase to the certificate holders.

Pursuant to Rule 23 of the Court of Chancery, the proposed settlement was set down for hearing and the certificate holders of the Fund given notice. Only the appellants appeared at the hearing as objectors and offered in opposition the testimony of an economist who characterized the proposed settlement as unfair. The Chancellor approved the settlement and from that approval this appeal is taken.

Recently, in *Rome* v. *Archer*, 197 A.2d 49, we had occasion to restate the function of this court on appeal from

an approval of the settlement of a derivative action. We pointed out that we review the record for the sole purpose of determining whether or not under the circumstances the approval of the Chancellor of the settlement was an abuse of his discretion, and that in order to make a finding that he abused his discretion the evidence must be strongly to the contrary. We approach the decision in this appeal in the light of this limitation.

Appellants argue that there was no evidence properly before the Chancellor except the testimony of their expert witness who characterized the settlement as unfair. We think not, however, for at the hearing the Chancellor ruled that the entire record was before him for the purpose of passing on the settlement. The appellants argue there was no actual offer into evidence of the depositions, exhibits, etc. However, these were all before the Chancellor and he obviously decided the case upon them. To argue that because no formal offer into evidence was made the matters contained in the record may not be considered, is to stand upon too narrow a technicality, particularly in view of the Chancellor's statement from the Bench that he would decide the case upon everything on file. The point is without merit.

Next, appellants argue that since the Funds as such had no board of directors and since the directors of Keystone, the trustee, performed the functions of a board of directors of the Funds, it follows that the individual defendants are at one and the same time directors of the investment adviser, Keystone, and of the Funds in violation of §10(a) of the Act which prohibits more than 60% of such a board from being "affiliated" with the investment adviser. It is therefore argued that the complaint set forth a valid enforceable claim under the Act which was improvidently given up by the settlement.

In the first place, Keystone is not the investment adviser of the Funds. It is the trustee. As such, therefore, it is excluded in terms from the statutory definition of an investment adviser found in §2(a)19 of the Act. Furthermore, there is in existence no investment advisory contract between Keystone and the Funds which, under §15(a) of the Act, must by law be approved by a majority of the shareholders.

In the second place, since the Funds do not have an investment adviser within the meaning of the Act, it follows that there is none with whom directors of the Funds could be "affiliated" within the prohibitory limits of §10(a) of the Act. Furthermore, it is obvious to us that the relationship between Keystone and the Funds and its certificate holders is that of trustee and beneficiary. The propriety of this relationship under the Act seems to be recognized by §16(b).

The whole of appellants' argument based upon the Act seems little more than an attempt to distort the true nature of the Funds and Keystone into a mold which would fit neatly into one of the prohibited areas of the Act. The difficulty is, however, that the argument in reality is a complaint that the Congress did not pass the Act in a form more acceptable to appellants.

Next, appellants argue that since Keystone was at the same time trustee and adviser of the Funds, an improper conflict of interest existed which will be perpetuated by the settlement. The difficulty with the argument is that this situation existed at the time the certificate holders acquired their interest in the Funds. It is true, of course, that the compensation arrangement was in no sense a negotiated one, but this, too, was obvious to any investor in the Funds. There is no rule of common law we know of which

makes such an arrangement invalid. The usual rule prohibiting trustees from self-dealing, we think, has no application to this arrangement set up by contract and of which the investor knew when he acquired his interest in the Funds.

Appellants argue that since the complaint charges a waste of the Funds' assets, making applicable the rule of *Rogers* v. *Hill, supra,* the ratification by the certificate holders is entitled to no consideration. While the doctrine of *Rogers* v. *Hill* was held to be applicable in this case if the facts of waste were established the Chancellor in *Saminsky* v. *Abbott, supra,* reserved for future determination what these facts were. Such determination was forestalled, however, by the agreement of settlement. The allegation of waste in the complaint, however, does not, of itself, establish a waste of assets. It is quite apparent to us that the Chancellor considered the charge of waste and was of the opinion that, even if successfully established, it was doubtful at least that the ultimate recovery would have exceeded the settlement gains. Having reached this conclusion, it was proper for the Chancellor to give to the shareholders' ratification some consideration. *Saxe* v. *Brady,* 184 A.2d 602. At the very least, such ratification demonstrates that reasonable businessmen might differ upon the propriety of the settlement in which event the duty of the court is to approve the settlement. *Rome* v. *Archer, supra.*

Finally, appellants argue that the management fees and recurring charges established by the settlement agreement are excessive and are noncompetitively established. The answer to this contention is that the fees and charges paid by the Funds when compared to the fees and charges of other investment companies which have been approved by

the courts are not only in line but are less. See *Saxe* v. *Brady, supra,* and *Acampora* v. *Birkland,* 220 F.Supp. 527. If this comparison is not conclusive of the matter, yet it casts a heavy doubt upon the ability to press the claim for excessive compensation to a successful conclusion. So heavy is this doubt, in fact, that alone it justifies the approval of the settlement by the exercise of business judgment.

Appellant, however, argues that a comparison with the fees paid by other investment companies is meaningless because none of the fees has been established competitively. It seems to us, however, that generally speaking the fact that all such fees show a pattern of uniformity suggests strongly that they have been established by forces which, in a sense, are the equivalent of competition. Furthermore, appellants do not suggest any means of using competition to establish fees, nor can we think of one. The economic facts preclude it.

We conclude, therefore, that the appellants have failed to demonstrate any illegality in the structure of this investment operation, or to demonstrate that the complaint sets forth a cause of action for excessive compensation or waste of assets which had any reasonable probability of ultimate success in the event of trial on the merits. This being so, the approval of the settlement by the Chancellor was a proper exercise of business judgment.

The judgment below is affirmed.

INVESTMENT COMPANY ACT OF 1940

Findings and Declaration of Policy

* * *

Sec. 1. * * * (b) Upon the basis of facts disclosed by the record and reports of the Securities and Exchange Commission made pursuant to section 30 of the Public Utility Holding Company Act of 1935, and facts otherwise disclosed and ascertained, it is hereby declared that the national public interest and the interest of investors are adversely affected—

* * *

(2) when investment companies are organized, operated, managed, or their portfolio securities are selected, in the interest of directors, officers, investment advisers, depositors, or other affiliated persons thereof, in the interest of underwriters, brokers, or dealers, in the interest of special classes of their security holders, or in the interest of other investment companies or persons engaged in other lines of business, rather than in the interest of all classes of such companies' security holders;

* * *

It is hereby declared that the policy and purposes of this title, in accordance with which the provisions of this title shall be interpreted, are to mitigate and, so far as feasible, to eliminate the conditions enumerated in this section which adversely affect the national public interest and the interest of investors.

General Definitions

Sec. 2. (a) When used in this title, unless the context otherwise requires—

(1) "Advisory board" means a board, whether elected or appointed, which is distinct from the board of directors

or board of trustees, of an investment company, and which is composed solely of persons who do not serve such company in any other capacity, whether or not the functions of such board are such as to render its members "directors" within the definition of that term, which board has advisory functions as to investments but has no power to determine that any security or other investment shall be purchased or sold by such company.

• • •

(12) "Director" means any director of a corporation or any person performing similar functions with respect to any organization, whether incorporated or unincorporated, including any natural person who is a member of a board of trustees of a management company created as a common-law trust.

• • •

(19) "Investment adviser" of an investment company means (A) any person (other than a bona fide officer, director, trustee, member of an advisory board, or employee of such company, as such) who pursuant to contract with such company regularly furnishes advice to such company with respect to the desirability of investing in, purchasing or selling securities or other property, or is empowered to determine what securities or other property shall be purchased or sold by such company,

• • •

Affiliations of Directors

Sec. 10. (a) After one year from the effective date of this title, no registered investment company shall have a board of directors more than 60 per centum of the members of which are persons who are investment advisers of, affiliated persons of an investment adviser of, or officers or employees of, such registered company.

• • •

(h) In the case of a registered management company which is an unincorporated company not having a board of directors, the provisions of this section shall apply as follows:

(1) the provisions of subsection (a), as modified by subsection (e), shall apply to the board of directors of the depositor of such company;

• • •

Investment Advisory and Underwriting Contracts

Sec. 15. (a) After one year from the effective date of this title it shall be unlawful for any person to serve or act as investment adviser of a registered investment company, except pursuant to a written contract, which contract, whether with such registered company or with an investment adviser of such registered company, unless in effect prior to March 15, 1940, has been approved by the vote of a majority of the outstanding voting securities of such registered company and—

(1) precisely describes all compensation to be paid thereunder;

(2) shall continue in effect for a period more than two years from the date of its execution, only so long as such continuance is specifically approved at least annually by the board of directors or by vote of a majority of the outstanding voting securities of such company;

(3) provides in substance, that it may be terminated at any time, without the payment of any penalty, by the board of directors of such registered company or by vote of a majority of the outstanding voting securities of such company on not more than sixty days' written notice to the investment adviser; and

(4) provides, in substance, for its automatic termination in the event of its assignment by the investment adviser.

• • •

(d) It shall be unlawful for any person—

(1) to serve or act as investment adviser of a registered investment company, pursuant to a written contract which was in effect prior to March 15, 1940. after March 15, 1945, or the date of termination provided for in such contract, whichever is the prior date, or after assignment thereof subsequent to March 15, 1940, by the person acting as investment adviser thereunder; or

(2) as principal underwriter for a registered open-end investment company to offer for sale, sell, or deliver after sale any security of which such company is the issuer, pursuant to a written contract which was in effect prior to March 15, 1940, after March 15, 1945, or the date of termination provided for in such contract, whichever is the prior date, or after assignment thereof subsequent to March 15, 1940, by the person acting as principal underwriter thereunder:

Provided, however, That the limitation to March 15, 1945, shall not apply in either case if prior to that date such contract is renewed in such form that it complies with the requirements of subsection (a) or (b) of this section, as the case may be, and is approved in the manner required by this section in respect of a contract of the same character made after March 15, 1940.

(e) In the case of a common-law trust of the character described in subsection (b) of section 16, either written approval by holders of a majority of the outstanding

shares of beneficial interest or the vote of a majority of such outstanding shares cast in person or by proxy at a meeting called for the purpose shall for the purposes of this section be deemed the equivalent of the vote of a majority of the outstanding voting securities, and the provisions of paragraph (40) of section 2 (a) as to a majority shall be applicable to the vote cast at such a meeting.

• • •

Changes in Board of Directors; Provisions Relative to Strict Trusts

Sec. 16. (a) No person shall serve as a director of a registered investment company unless elected to that office by the holders of the outstanding voting securities of such company, at an annual or a special meeting duly called for that purpose;

• • •

(b) The provisions of subsection (a) of this section shall not apply to a common-law trust existing on the date of enactment of this title under an indenture of trust which does not provide for the election of trustees by the shareholders.

• • •

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1964

No. 392

SIDNEY C. KLEINMAN and JANICE R. KLEINMAN,
Petitioners-Objectors,
vs.
HYMAN SAMINSKY and BETTY SIEGEL, Trustee for JOAN C. SIEGEL,
and
Respondents-Plaintiffs,
CHARLES C. ABBOTT, WILFRED GODFREY, J. LEE POTTER, ORA C. ROEHL, ERWIN H. SCHELL, SIDNEY L. SHOLLEY, CAMERON S. THOMPSON, SAM G. BAGGETT, GLENN N. LEMPEREUR, KEYSTONE CUSTODIAN FUNDS, INC., KEYSTONE CUSTODIAN FUNDS, INC., as Trustee, and THE KEYSTONE COMPANY OF BOSTON,
Respondents-Defendants.

ON PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF THE STATE OF DELAWARE

BRIEF FOR RESPONDENTS-DEFENDANTS IN OPPOSITION

ALFRED JARETZKI, JR.,
MARVIN SCHWARTZ,
Sullivan & Cromwell,
48 Wall Street,
New York 5, N. Y.

JAMES M. TUNNELL, JR.,
WILLIAM S. MEGONIGAL, JR.,
Morris, Nichols, Arsht & Tunnell,
3000 duPont Building,
Wilmington, Delaware,

Attorneys for Respondents-Defendants.

September 15, 1964

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SIDNEY C. KLEINMAN and JANICE R. KLEINMAN,
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Respondents-Defendants.

ON PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF THE STATE OF DELAWARE

BRIEF FOR RESPONDENTS-DEFENDANTS IN OPPOSITION

Opinions Below

The opinion of the Delaware Supreme Court (Pet. 1a) is reported at 194 A. 2d 549. The opinion of the Dela-

ware Court of Chancery (PA63)* is reported at 194 A. 2d 549.

The Question Presented

Was the approval by the courts below of a settlement of a class action involving an investment company a proper exercise of business judgment?

Statutory Provisions

The pertinent provisions of the Investment Company Act of 1940, 15 U.S.C. §80a, are set forth in an appendix to this brief.

Statement

The Delaware Supreme Court and Court of Chancery have approved "as a matter of business judgment" (Pet. 9a, PA70) the settlement of a class action brought by several holders of certificates of participation in the Keystone Custodian Funds. Notice of the proposed settlement was given to the Funds' 230,000 certificateholders and only petitioners, a lawyer and his wife, objected. Petitioners ask this Court to review the business judgment exercised by the Delaware courts in approving the settlement, claiming that the approval was based upon a misconception of the Investment Company Act.

The ten Keystone Custodian Funds are common law "Massachusetts trusts", each existing under a separate trust instrument. The trusts were created in 1935; after enactment of the Investment Company Act of 1940, 15 U.S.C. §80a, each Fund registered with the Securities and

* References to Petitioners' Appendix in the Delaware Supreme Court are abbreviated "PA". References to Respondents-Defendants' Appendix in the Delaware Supreme Court are abbreviated "RA".

Exchange Commission under that Act as an open-end investment company or mutual fund (RA4).

The trustee of each Fund is respondent Keystone Custodian Funds, Inc. ("Keystone") which, pursuant to the terms of the trust instruments, performs all of the investment management and administrative services required by the Funds (RA2, pp. 8-9). The trust instruments provide for the payment to the trustee of a management fee of ½ of 1% annually on the first $150 million in aggregate Fund assets and ⅜ of 1% annually on aggregate Fund assets in excess of that amount. The trust instruments provide further for the payment of a "recurring charge" of ¼ of 1% annually in lieu of all operating and administrative expenses (RA2, p. 4).*

Each of the ten Funds has a separate portfolio and a distinct investment policy (RA1-2, 76, p. 3). Certificates of participation in each of the Funds are offered for sale to the public in accordance with the terms of a principal underwriting contract between Keystone, the trustee, and the respondent Keystone Company of Boston ("Keystone-Boston"), a wholly owned subsidiary of Keystone.

The Complaint

The complaint, as amended (PA16), alleges that the management fee and recurring charge specified in the trust instruments are excessive and a waste of the Funds' assets, challenges the validity of the underwriting contract between Keystone and Keystone-Boston and complains of the manner in which brokerage commissions are allocated with respect to transactions in the portfolio securities of the Funds.

* The management fee and recurring charge with respect to Series B-1, a high-grade bond fund, are half those paid by the other nine funds. Under the proposed settlement, the B-1 management fee and recurring charge will continue to be half that charged the other funds.

Ratification by the Funds' Certificateholders

While this action was pending in the trial court, the certificateholders of all ten Keystone Funds voted overwhelmingly to ratify and approve all payments of management fees and recurring charges made to Keystone pursuant to the provisions of the trust instruments. The certificateholders further approved a new underwriting contract between Keystone and Keystone-Boston and ratified and approved all past underwriting contracts and transactions thereunder (RA82-89).

More than 90% of the certificateholders of each Fund—including petitioners (RA106)—voted for ratification (RA90-91).

The proxy statement, on the basis of which the certificateholders ratified the matters now complained of, fairly described the complaint in this action and stated that ratification, if given, "will be asserted in defense of the litigation" (RA80, p. 2). All payments to Keystone and Keystone-Boston were stated in detail for a number of years (pp. 3-4). Complete financial statements were given both for Keystone and Keystone-Boston (pp. 6-7). Keystone's directors were identified and their stock holdings in Keystone were given (p. 5). Their affiliations with Keystone were reported, as was the fact that all but two were defendants in this action (p. 5).

Petitioner Sidney C. Kleinman is a lawyer (RA94). He could hardly be heard to say that he did not understand the proxy statement or the significance of the proxy of ratification which he signed.

The Settlement

The most common fee for management services in the investment company industry is a "flat" ½ of 1% annually of the fund's average net assets (Hearing Ex. 3). In

addition, almost every fund bears some expenses of operation in addition to the management fee (RA47).

Even prior to the settlement, the Keystone management fee was substantially less than the standard flat ½ of 1%; it was ⅜ of 1% on so much of the aggregate net assets of all ten Funds as exceeded $150 million (RA53-54).

The Keystone Funds bear none of their expenses of operation (RA47, 60-61). In lieu thereof, they pay a "recurring charge" to Keystone, the trustee, which assumes responsibility for all operating expenses (RA2, p. 4). Prior to the settlement, the recurring charge was ¼ of 1% annually of the aggregate net assets of the ten Funds (RA53).

The settlement provides for reductions in the management fee and recurring charge. The new management fee and recurring charge are (RA36-37):

Aggregate Assets of 10 Funds (millions of dollars)	Management Fee Rate	Recurring Charge Rate
First $150	0.5 %	0.25 %
$150 to $500	0.375%	0.25 %
$500 to $750	0.35 %	0.175%
$750 to $1,000	0.325%	0.16 %
$1,000 to $1,250	0.3 %	0.15 %
Over $1,250	0.275%	0.14 %

At the time of the settlement hearing, the net assets of the ten Keystone Funds were $771,000,000; at that asset figure, the settlement would yield an annual saving to the Funds in excess of $250,000 (PA68).

This annual saving, of course, will increase as the Funds grow in size. The following schedule shows the saving

which would accrue to the ten Funds in the aggregate, at varying asset levels, by reason of the settlement:*

Asset Level in hundreds of millions of dollars	Management Fee		Recurring Charge		Total		Saving to Funds
	Present	Proposed	Present	Proposed	Present	Proposed	
500	2,062,500	2,062,500	1,250,000	1,250,000	3,312,500	3,312,500	—
600	2,437,500	2,412,500	1,500,000	1,425,000	3,937,500	3,837,500	100,000
700	2,812,500	2,762,500	1,750,000	1,600,000	4,562,500	4,362,500	200,000
750	3,000,000	2,937,500	1,875,000	1,687,500	4,875,000	4,625,000	250,000
800	3,187,500	3,100,000	2,000,000	1,767,500	5,187,500	4,867,500	320,000
900	3,562,500	3,425,000	2,250,000	1,927,500	5,812,500	5,352,500	460,000
1,000	3,937,500	3,750,000	2,500,000	2,087,500	6,437,500	5,837,500	600,000

Apart from savings measurable directly in dollars, the settlement would give to the certificateholders the permanent right to reject any increase in compensation proposed by the trustee. And for a period of eight years, the trustee could not seek any increase in compensation except in the event of a substantial change in circumstances which made its compensation unreasonably low in relation to services rendered and the Chancellor granted leave to the trustee to submit the proposed increase to the certificateholders (PA38).

Notice of the proposed settlement was given pursuant to order of the court to all certificateholders of the Funds (RA33). Of more than 230,000 certificateholders, only petitioners objected to the settlement.

* As already noted, the B-1 Fund would continue to pay a management and recurring charge at half the prescribed rate. The figures given above assume that B-1 would pay the same fee and recurring charge as the other Funds; any other basis of computation would require an assumption with respect to B-1's assets. However, the figures in the final column are not affected. The assets of the B-1 Fund as of December 31, 1962 were $6.8 million (Hearing Ex. 3).

The Decision Below

After a hearing on notice to all certificateholders of the Funds and after consideration of petitioners' evidence and the entire record in the case, the Chancellor concluded that "as a matter of business judgment, • • • the settlement is fair and reasonable in the present setting and will be approved" (PA70).

The Chancellor painstakingly reviewed petitioners' contentions, noting the "difficulties plaintiffs would face if the matter were to proceed to a final hearing" (PA69). The Chancellor observed that even assuming the validity of legal contentions advanced by petitioners and by plaintiffs, the right to recover damages "is by no means clear" (PA70).

On appeal by petitioners, the Supreme Court of Delaware held that "the approval of the settlement by the Chancellor was a proper exercise of business judgment" (Pet. 9a).

Argument

1. The Delaware judgment which petitioners seek to review decided no question of law and certainly no substantial question of federal law. All that was decided was that a settlement negotiated by the parties was, *as a matter of business judgment*, fair and reasonable. In considering a proposed settlement of a class action, the court does not decide the contentions of either party. As the Delaware Supreme Court has said of its function in these circumstances,

> "The function of the court is discharged, however, when the nature of the claim, the possible defenses to it, the legal and factual obstacles facing the plaintiff in the event of trial are weighed and considered. If, in the light of these matters, the court

> approves the settlement as reasonable through the exercise of sound business judgment, its function as the so-called third party to the settlement has been discharged." *Rome* v. *Archer*, 197 A. 2d 49 (Del. 1954).

Petitioners thus wholly misconceive the nature of a settlement when they contend that there has been an erroneous decision on a substantial question of federal law. Indeed, the Delaware Supreme Court indicated that it would have approved the settlement even if it appeared that there was some merit to petitioners' contentions; the Court said (Pet. 9a) that comparison of the Keystone fees with those paid by other investment companies "alone • • • justifies approval of the settlement". Moreover, the prior certificateholder ratification of the transactions challenged by the complaint and petitioners' own proxy of ratification might in themselves preclude objection by petitioners.

2. The federal question which petitioners pose is so narrow in its scope that very probably it concerns no investment company other than the Keystone Funds. It is incorrect to state, as petitioners do (Pet. 3, 10), that the question affects one-fourth of all the mutual funds in the United States. Petitioners rely for this erroneous assertion of public importance upon *A Study of Mutual Funds*, H. Rep. No. 2274, 87th Cong., 2d Sess. (1962), a report on the investment company industry which was submitted to the Congress by the Securities and Exchange Commission. It appears from the study that while about one-fourth of the country's investment companies are trusts (*Id.* at p. 6), only ten (including the Keystone Funds as a single unit) have *corporate* trustees.* The remaining trustees are natural persons (*Id.* at p. 46) and

* The Keystone Funds are the only large trusts having a corporate trustee. See *A Study of Mutual Funds*, p. 47.

petitioners agree that natural persons who serve as trustees (not being "investment advisers" within the meaning of the Investment Company Act) may do so without violation of the Act. As to the nine other funds which are served by corporate trustees, the study does not indicate whether those funds have boards of directors so constituted as to comply with petitioners' strained reading of the Act. Finally, there is no substance whatever to petitioners' suggestion that "the Act may be evaded today" by the creation of an investment company in trust form (Pet. 10). Section 16 of the Act requires that fund directors, even in the case of a common law trust, be elected by certificateholders; the only trusts which are exempt from this provision are those, like Keystone, which were "existing on the date of enactment of this title" (§16(b)).

3. Petitioners contend that Keystone, the corporate trustee of the ten Keystone Funds, is the Funds' "investment adviser" within the meaning of Section 2(a)(19) of the Investment Company Act and that the board of directors of the corporate trustee is in fact the board of directors of each of the ten Funds. Therefore, petitioners argue, the board's constitution is unlawful under Section 10(a) of the Act, which provides that no more than 60% of a fund's board of directors may consist of persons who are affiliated with the fund's investment adviser. If Keystone is indeed an "investment adviser", Section 15 of the Act would require that its retention be approved periodically either by a properly constituted board of directors of the Funds *or* by the Fund's certificateholders.

Petitioners' circular contention is a distortion of the Investment Company Act and is, in any event, irrelevant here.

(a) Even if Keystone, the corporate trustee, were an "investment adviser", it could lawfully continue in that capacity so long as its continuance was approved periodically by certificateholders of the Funds in accordance with Section 15 of the Act. Thus, even if petitioners are correct in their contention that the trustee is an "investment adviser", there would be nothing inherently unlawful in the structure of the Funds.

(b) Keystone is not an "investment adviser" as that term is defined in Section 2(a)(19) of the Act, which provides in relevant part as follows:

> "'Investment adviser' of an investment company means (A) any person (other than a bona fide officer, director, trustee, member of an advisory board, or employee of such company, as such) who pursuant to contract with such company regularly furnishes advice to such company with respect to the desirability of investing in, purchasing or selling securities or other property, or is empowered to determine what securities or other property shall be purchased or sold by such company. * * *."

Keystone is admittedly a "trustee", but petitioners argue that only natural persons qualify for the "trustee" exemption. However, petitioners ignore Section 2(a)(27) of the Act, which defines "person" as used in the Act to mean "a natural person or a company". Thus, the person who may be a trustee under Section 2(a)(19) may be a natural person or a company. It is significant that *A Study of Mutual Funds*, the report upon which petitioners rely, states categorically that Keystone is "legally trustee under deeds of trust rather than an adviser" (*Id.* at p. 441).

(c) The record shows that the Securities and Exchange Commission, which is charged with the administration and enforcement of the Investment Company Act, does not agree with petitioners' contention that Keystone has been serving unlawfully as an investment adviser for over 20 years. Keystone's structure was reviewed in detail with the Commission staff after passage of the Act (RA4-11) and technical questions arising out of Keystone's trust form were under frequent review thereafter (RA21-26). Moreover, Keystone's structure is necessarily laid bare in annual prospectuses (RA76), which cannot become effective except by order of the Commission, and in proxy statements (*e.g.*, RA80), which must be filed with the Commission prior to distribution. In the unlikely event that the Commission may one day come to share petitioners' view of the Act, the judgment approving the settlement of this case could not bar the Commission from seeking appropriate injunctive and other relief under Section 42(e) of the Act.

4. The decisions cited in the petition (pp. 17-20) are not even remotely relevant. There is no conflict between the approval of the settlement by the courts below and any decision anywhere which has been brought to our attention.

CONCLUSION

For the foregoing reasons it is respectfully submitted that the petition for a writ of certiorari should be denied.

Respectfully submitted,

ALFRED JARETZKI, JR.,
MARVIN SCHWARTZ,
Sullivan & Cromwell,
48 Wall Street,
New York 5, N. Y.

JAMES M. TUNNELL, JR.,
WILLIAM S. MEGONIGAL, JR.,
Morris, Nichols, Arsht & Tunnell,
3000 duPont Building,
Wilmington, Delaware,

Attorneys for Respondents-Defendants.

September 15, 1964

APPENDIX

Investment Company Act of 1940, 15 U.S.C. §80a

Definitions

2(a) (19) "Investment adviser" of an investment company means (A) any person (other than a bona fide officer, director, trustee, member of an advisory board, or employee of such company, as such) who pursuant to contract with such company regularly furnishes advice to such company with respect to the desirability of investing in, purchasing or selling securities or other property, or is empowered to determine what securities or other property shall be purchased or sold by such company . . .

(27) "Person" means a natural person or a company.

Affiliations of Directors

SEC. 10. (a) After one year from the effective date of this title, no registered investment company shall have a board of directors more than 60 per centum of the members of which are persons who are investment advisers of, affiliated persons of an investment adviser of, or officers or employees of, such registered company.

(h) In the case of a registered management company which is an unincorporated company not having a board of directors, the provisions of this section shall apply as follows:

(1) the provisions of subsection (a), as modified by subsection (e), shall apply to the board of directors of the depositor of such company;

(2) the provisions of subsections (b) and (c), as modified by subsection (e), shall apply to the board of directors of the depositor and of every investment adviser of such company.

. . . . .

Investment Advisory and Underwriting Contracts

SEC. 15. (a) After one year from the effective date of this title it shall be unlawful for any person to serve or act as investment adviser of a registered investment company, except pursuant to a written contract, which contract, whether with such registered company or with an investment adviser of such registered company, unless in effect prior to March 15, 1940, has been approved by the vote of a majority of the outstanding voting securities of such registered company and—

(1) precisely describes all compensation to be paid thereunder;

(2) shall continue in effect for a period more than two years from the date of its execution, only so long as such continuance is specifically approved at least annually by the board of directors or by vote of a majority of the outstanding voting securities of such company;

(3) provides, in substance, that it may be terminated at any time, without the payment of any penalty, by the board of directors of such registered company or by vote of a majority of the outstanding voting securities of such company on not more than sixty days' written notice to the investment adviser; and

(4) provides, in substance, for its automatic termination in the event of its assignment by the investment adviser.

• • • • •

(c) In addition to the requirements of subsections (a) and (b) it shall be unlawful for any registered investment company having a board of directors to enter into, renew, or perform any contract or agreement, written or oral, except a written agreement which was in effect

prior to March 15, 1940, whereby a person undertakes regularly to serve or act as investment adviser of or principal underwriter for such company, unless the terms of such contract or agreement and any renewal thereof have been approved (1) by a majority of the directors who are not parties to such contract or agreement or affiliated persons of any such party, or (2) by the vote of a majority of the outstanding voting securities of such company.

* * * * *

(e) In the case of a common-law trust of the character described in subsection (b) of section 16, either written approval by holders of a majority of the outstanding shares of beneficial interest or the vote of a majority of such outstanding shares cast in person or by proxy at a meeting called for the purpose shall for the purposes of this section be deemed the equivalent of the vote of a majority of the outstanding voting securities, and the provisions of paragraph (40) of section 2 (a) as to a majority shall be applicable to the vote cast at such a meeting.

(f) Nothing contained in this section shall be deemed to require or contemplate any action by an advisory board of any registered company or by any of the members of such a board.

Changes in Board of Directors; Provisions Relative to Strict Trusts

SEC. 16. (a) No person shall serve as a director of a registered investment company unless elected to that office, by the holders of the outstanding voting securities of such company, at an annual or a special meeting duly called for that purpose; except that vacancies occurring between such meetings may be filled in any otherwise legal manner

if immediately after filling any such vacancy at least two-thirds of the directors then holding office shall have been elected to such office by the holders of the outstanding voting securities of the company at such an annual or special meeting. In the event that at any time less than a majority of the directors of such company holding office at that time were so elected by the holders of the outstanding voting securities, the board of directors or proper officer of such company shall forthwith cause to be held as promptly as possible and in any event within sixty days a meeting of such holders for the purpose of electing directors to fill any existing vacancies in the board of directors unless the Commission shall by order extend such period. The foregoing provisions of this subsection shall not apply to members of an advisory board.

Nothing herein shall, however, preclude a registered investment company from dividing its directors into classes if its charter, certificate of incorporation, articles of association, by-laws, trust indenture, or other instrument or the law under which it is organized, so provides and prescribes the tenure of office of the several classes: *Provided,* That no class shall be elected for a shorter period than one year or for a longer period than five years and the term of office of at least one class shall expire each year.

(b) The provisions of subsection (a) of this section shall not apply to a common-law trust existing on the date of enactment of this title under an indenture of trust which does not provide for the election of trustees by the shareholders. No natural person shall serve as trustee of such a trust, which is registered as an investment company, after the holders of record of not less than two-thirds of the outstanding shares of beneficial interest in

such trust have declared that he be removed from that office either by declaration in writing filed with the custodian of the securities of the trust or by votes cast in person or by proxy at a meeting called for the purpose. Solicitation of such a declaration shall be deemed a solicitation of a proxy within the meaning of section 20 (a).

The trustees of such a trust shall promptly call a meeting of shareholders for the purpose of voting upon the question of removal of any such trustee or trustees when requested in writing so to do by the record holders of not less than 10 per centum of the outstanding shares.

Whenever ten or more shareholders of record who have been such for at least six months preceding the date of application, and who hold in the aggregate either shares having a net asset value of at least $25,000 or at least 1 per centum of the outstanding shares, whichever is less, shall apply to the trustees in writing, stating that they wish to communicate with other shareholders with a view to obtaining signatures to a request for a meeting pursuant to this subsection (b) and accompanied by a form of communication and request which they wish to transmit, the trustees shall within five business days after receipt of such application either—

(1) afford to such applicants access to a list of the names and addresses of all shareholders as recorded on the books of the trust; or

(2) inform such applicants as to the approximate number of shareholders of record, and the approximate cost of mailing to them the proposed communication and form of request.

If the trustees elect to follow the course specified in paragraph (2) of this subsection (b) the trustees, upon the written request of such applicants, accompanied by

a tender of the material to be mailed and of the reasonable expenses of mailing, shall, with reasonable promptness, mail such material to all shareholders of record at their addresses as recorded on the books, unless within five business days after such tender the trustees shall mail to such applicants and file with the Commission, together with a copy of the material to be mailed, a written statement signed by at least a majority of the trustees to the effect that in their opinion either such material contains untrue statements of fact or omits to state facts necessary to make the statements contained therein not misleading, or would be in violation of applicable law, and specifying the basis of such opinion.

After opportunity for hearing upon the objections specified in the written statement so filed, the Commission may, and if demanded by the trustees or by such applicants shall, enter an order either sustaining one or more of such objections or refusing to sustain any of them. If the Commission shall enter an order refusing to sustain any of such objections, or if, after the entry of an order sustaining one or more of such objections, the Commission shall find, after notice and opportunity for hearing, that all objections so sustained have been met, and shall enter an order so declaring, the trustees shall mail copies of such material to all shareholders with reasonable promptness after the entry of such order and the renewal of such tender.

Enforcement of Title

42 (e) Whenever it shall appear to the Commission that any person has engaged or is about to engage in any act or practice constituting a violation of any provision of this title, or of any rule, regulation, or order

hereunder, it may in its discretion bring an action in the proper district court of the United States, or the proper United States court of any Territory or other place subject to the jurisdiction of the United States, to enjoin such acts or practices and to enforce compliance with this title or any rule, regulation, or order hereunder. Upon a showing that such person has engaged or is about to engage in any such act or practice, a permanent or temporary injunction or decree or restraining order shall be granted without bond. In any proceeding under this subsection to enforce compliance with section 7, the court as a court of equity may, to the extent it deems necessary or appropriate, take exclusive jurisdiction and possession of the investment company or companies involved and the books, records, and assets thereof, wherever located; and the court shall have jurisdiction to appoint a trustee, who with the approval of the court shall have power to dispose of any or all of such assets, subject to such terms and conditions as the court may prescribe. The Commission may transmit such evidence as may be available concerning any violation of the provisions of this title, or of any rule, regulation, or order thereunder, to the Attorney General, who, in his discretion, may institute the appropriate criminal proceedings under this title.

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No. 392

IN THE

Supreme Court of the United States

OCTOBER TERM, 1964

SIDNEY C. KLEINMAN and JANICE R. KLEINMAN,
Objectors-below, Petitioners,

vs.

HYMAN SAMINSKY and BETTY SIEGEL, Trustee for JOAN C. SIEGEL,
Plaintiffs-Respondents,

and

CHARLES C. ABBOTT, *et al.*,
Defendants-Respondents.

PETITIONERS' BRIEF IN REPLY TO RESPONDENTS' BRIEF IN OPPOSITION

ALEX ELSON
WILLARD J. LASSERS
AARON S. WOLFF
11 South LaSalle Street
Chicago, Illinois 60603

ARTHUR T. SUSMAN
208 South LaSalle Street
Chicago, Illinois 60604
Counsel for Petitioners

FRANK J. MILLER
325 Delaware Trust Building
Wilmington, Delaware
Of Counsel

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and

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Defendants-Respondents.

PETITIONERS' BRIEF IN REPLY TO RESPONDENTS' BRIEF IN OPPOSITION.

The Court Below Decided a Substantial Federal Question, Without Reliance Upon the Business Judgment Rule.

Respondents highlight the "business judgment" rule in an effort to obscure the substantial federal question in this case. The court below unquestionably decided that Keystone, as a trustee, is not an investment adviser under §2(a)(19) of the Investment Company Act of 1940 and that therefore there is no violation of §§ 10 and 15 of the Act. (App. 6a-7a). It was only after the court below concluded there was no "illegality in the structure of this investment operation • • •" that the court applied the business judgment rule (App. 9a). The business judgment

rule goes only to the fairness and reasonableness of the plan of settlement, not to the question of whether the structure of the funds was legal under the Investment Company Act. It is as to the latter question that certiorari is sought. On the face of its opinion, the court below decided the federal questions presented in the petition (Pet. 2, 9).

Respondents' attempt to confuse the issue by changing the question presented to emphasize the business judgment rule does not jive with their position that the federal question decided by the court below is not substantial (Resp. 8) and that the decision is correct (Resp. 9-11).

The court below could not have avoided the federal questions under the guise of the business judgment rule. Parties may not enter into a settlement agreement and courts may not approve or give effect to an agreement which contravenes an act of Congress. *Tennessee C. & I. R. Co.* v. *Muscoda Local 123*, 321 U.S. 590, 602-3 (1944); *Brooklyn Bank* v. *O'Neill*, 324 U.S. 697 (1945); *Boyd* v. *Grand Trunk Western R. Co.*, 338 U.S. 263 (1949); *Atlantic Co.* v. *Broughton*, 146 F. 2d 480, 482 (C.A. 5, 1944), cert. denied 324 U.S. 883 (1945); see also, *Lucas* v. *The Forty-Fourth General Assembly*, 377 U.S. 713 (1964), applying this principle on a constitutional level. Section 47(a) of the Act expressly prohibits the parties from entering into any agreement waiving rights or duties created under the Act. 15 U.S.C. § 80a-46(a). Under a comparable provision of the Securities Act of 1933, 15 U.S.C. § 77n, this Court held void an agreement to arbitrate *Wilko* v. *Swan*, 346 U.S. 427 (1953). Recognizing that it could not approve a settlement that sanctioned violation of federal law, the court below categorically decided the federal questions presented before applying the business judgment rule.

Respondents concede (Resp. 8-10, pars. 2 and 3) that the court below decided a federal question but argue that the question is not important or was decided correctly below. Respondents' argument that the federal question is not substantial is based on the false premise that natural persons may serve as trustees and be exempt as investment advisers under the Act (Resp. 8-9). Despite respondents' assertion, petitioners never stated and certainly do not agree that natural persons serving as trustees are exempt as investment advisers. Petitioners said only that individual members of a board of trustees may be exempt individually as investment advisers (Pet. 13-14). If respondents are correct that natural as well as corporate trustees are exempt as investment advisers then the implication of the decision below may be even broader than petitioners asserted.

Moreover, even if there are only ten investment companies now organized as common law trusts with corporate trustees, the question presented is of importance to hundreds of thousands of shareholders having hundreds of millions of dollars invested in investment companies. Indeed, the Keystone Funds alone have over 230,000 investors who have invested over $770,000,000.*

Respondents also assert that the Act may not be evaded today because §16 of the Act requires the Funds' directors to be elected by certificateholders (Resp. 9, p. 2). But that section does not deal with investment advisers and as petitioners stated (Pet. 10), if the decision below is correct, "the Act may be evaded today simply by creating investment companies in the form of common

* As of August 1, 1964, the Keystone Funds reported they had over 228,000 investors whose shares had a market value exceeding $902,000,000. (Report to Shareholders—Series S-4, dated August 31, 1964).

law trusts and by naming a 'trustee' to perform all of the functions of the investment adviser." That statement remains unchallenged.

Respondents concede that if Keystone is an investment adviser §15 would be violated, but argue that the defect is not "inherently unlawful" and could be cured by securing approval of the advisory contract periodically by the certificate holders (Resp. 9, 10). But the point is that the court below held (erroneously) that Keystone was not subject to the requirements of §15. It is irrelevant whether Keystone might comply with a provision of the Act that the court below held inapplicable.

Respondents restate but do not challenge petitioners' contention that if Keystone is an adviser, §10(a) of the Act has been and is being violated (Resp. 9, ¶ 3). As to the §10 violation, respondents do not even suggest that they could or would cure this defect in the Funds' structure without a directive from this Court.

In paragraph (b) on page 10, respondents attempt to come to grips, finally, with the true question presented, namely—whether Keystone is an investment adviser. Significantly, respondents have abandoned completely the scant and insupportable rationale of the court below. Respondents new tack is to ascribe to petitioners an argument they never made or would make—that only natural persons qualify for the trustee exemption.*

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* As pointed out above, petitioners never argued that "only natural persons qualify for the 'trustee' exemption" (Resp. 10). The phrase "natural persons" nowhere appears in the petition. What petitioners did say was that the meaning of trustee in the list of exemptions refers to an individual trustee who is a member of a board of trustees (Pet. 13-14).

Then, respondents say, since §2(a)(27) of the Act defines "person" as "a natural person or company", Keystone qualifies as an exempt person under §2(a)(19). Respondents thus find they must take a more extreme position to uphold the court below; for as respondents tell us (Resp. 8) there are more natural persons than corporations serving as trustees of investment trusts. While respondents would exempt all trustees under §2(a)(19), we think it is plain that Congress did not exempt as trustee any person—natural or artificial—who performs the duties and functions of an investment adviser. Respondents have left unanswered all of the other reasons advanced by petitioners as to why a trustee who performs all of the functions of an investment adviser is not exempted under §2(a)(19) as a trustee.

The poverty of respondents' position is demonstrated also by their quotation, out of context, of a parenthetical phrase at p. 441 of *A Study of Mutual Funds* (Resp. 10). The parenthetical phrase, "legally trustee under deeds of trust rather than an adviser," in context supports petitioners and reads as follows:

> "There are of course a substantial number of open-end companies and groups that do not have any external investment adviser, including MIT, Massachusetts Investors Growth Stock Fund, Century Shares Trust, and the three members of the Broad Street group. These internally managed systems are given attention here mainly because they afford a basis for comparison with companies with advisers. As may be seen by a comparison of tables VIII-7 and VIII-8 they constitute a significant fraction of the universe of open-end companies and assets, and they would be larger by another $851 million *if we had not chosen to include Keystone Custodian Funds, Inc.* (legally trustee under deeds of trust rather than

an adviser) *as an investment adviser for purposes of this study.* * * *" (emphasis added)

By treating Keystone in the group of open-end companies that do have external investment advisers, the *Study*, prepared by economists and professors at the Wharton School of Finance and Commerce for the Securities and Exchange Commission, chose to "include Keystone * * * as an investment adviser * * *". So do petitioners.

The parenthetical phrase states only what is obvious, namely that Keystone is labelled a trustee under a deed of trust. The *Study* was not there concerned with the question involved here—whether Keystone which is designated a trustee in the deed of trust is also exempt from all of the provisions of the Act with respect to advisers.*

Also without merit is respondents' argument that the Securities and Exchange Commission has not yet complained that Keystone's structure is unlawful (Resp. 11). Private enforcement of securities legislation provides a necessary supplement to Commission action. *J. I. Case Company* v. *Borak*, 377 U.S. 426 (1964). And the wisdom of that rule is evident here, since the chancery court held that the underwriting contract between Keystone of

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* Note also that the *Study* at p. 46, cited by respondents (Resp. 8), asserted that Keystone shareholders did not have power to vote annually on underwriting contracts. The *Study*, conducted by laymen, was not concerned with that assertion as a question of law but as a matter of fact and can hardly be criticised for not predicting that failure to obtain shareholder approval rendered such agreements void under the Act. See *Saminsky* v. *Abbott*, discussed at Petition 6 and in the following paragraph.

Boston and Keystone, a contract which had been in existence for over twenty years with the knowledge of the Commission, was void under the Act. See *Saminsky* v. *Abbott*, 185 A. 2d 765 (Del. Ch. 1961) discussed at Pet. 6.

Finally, respondents' argument based on ratification is totally irrelevant (Resp. 4, 6, 8). It relates to the application of the business judgment rule, a question which is not before this Court. The question is whether the structure of the Funds is in violation of the Act. The latter question was never before the certificateholders for ratification (DA 80—2 to 5; 106); nor was it before them in the notice of settlement (DA 33-39). In any event, as shown above, the illegal structure of the Funds may not be ratified or approved by certificateholders and a plan of settlement which sanctions continuing violations of the Act is void against public policy and cannot be approved by any court.*

Respondents also make much of the fact that of more than 230,000 certificateholders, only petitioners objected to the settlement (Resp. 6), a fact that we pointed out in the petition (Pet. 7). If there is any magic in numbers, we think that if two certificateholders can enter into a settlement agreement on behalf of 230,000 certificate

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* Respondents' assertion (Resp. 4) that more than 90% of the certificateholders of each fund, including petitioners, voted for ratification, is erroneous. For example, by far the largest of the 10 Keystone funds is "S 4". Only 58% of the outstanding shares of that fund were voted in favor of ratifying management fees (DA 91) and only one of petitioners signed a proxy (DA 106). Moreover, respondents' suggestion that petitioners lack standing to object because one of them signed a proxy was rejected expressly by the chancery court (PA 65) and sub-silencio by the Delaware Supreme Court, although respondents argued it there at length.

holders, then the same number can upset such a settlement—especially so where the settlement sanctions continuing violations of the Investment Company Act of 1940 and deprives hundreds of thousands of small investors of the protection congress intended them to have.

Conclusion.

For the reasons set out above and in the Petition, the petitioners respectfully request that this Court issue a Writ of Certiorari to the Supreme Court of Delaware and reverse the judgment of that court.

Respectfully submitted,

ALEX ELSON
WILLARD J. LASSERS
AARON S. WOLFF
11 South La Salle Street
Chicago, Illinois 60603

ARTHUR T. SUSMAN
208 South La Salle Street
Chicago, Illinois 60604
Counsel for Petitioners.

FRANK J. MILLER
325 Delaware Trust Building
Wilmington, Delaware
Of Counsel

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